PRODUCTIVITY COMMISSION'S DRAFT REPORT ON TELECOMMUNICATIONS COMPETITION REGULATION

PRIMUS' SUBMISSION

JULY 2001

Background

In March 2001 the Productivity Commission issued its draft report on its review of telecommunications competition regulation.

This is Primus' submission to that report.

Summary

In summary Primus contends that:

- Industry specific regulation (Part XIB and Part XIC) must be retained and strengthened as opposed to using Part IIIA and Part IV of the TPA;
- The skills and resources of the ACCC should be strengthened rather than removing its discretionary power;
- The LTIE test must remain;
- Responsibility for numbering and pre selection should be transferred from the ACA to the ACCC.
- Structural separation of Telstra's retail and wholesale business operations remains an important issue to ensuring a level playing field in the provision in of "monopoly" services and competitive services.

In support of these views Primus' arguments are as follows:

1. A continuing major barrier to competition is Telstra's control over critical bottleneck facilities.

2. Competition in many market segments of the telecommunications industry remains immature.

3. The telecommunications industry continues to exhibit unique structural and competitive characteristics, which support the argument for retaining telecommunications specific regulation in the TPA.

4. Until competition in telecommunications has broadened and deepened, moving to generic regulation will only serve to strengthen the position of dominant players in the market and further frustrate the opening up of, and access to, existing bottle neck facilities.

5. There has been no compelling evidence presented that the benefit of removing telecommunications industry specific regulation outweighs the risks of doing so.

6. The real issue in promoting competition in telecommunications is more to do with ensuring effective implementation and enforcement of existing competition policy rather than deficiencies in the policy itself.

State of Competition

Primus' major concern with the Productivity Commission report is that its recommendations are not consistent with a market where competition is still developing.

As the third or fourth largest carrier in the market, Primus' experience shows that while the regulatory regime which has been in place since 1997 has to some extent been effective there remain several major deficiencies which are inhibiting the development of sustainable competition in the market. The Productivity Commission's recommendations are effectively sending the signal that the current regime has worked well, that competition is healthy and robust, and that therefore Telstra should be unburdened by regulation.

Primus strongly contends that competition in many market segments of the industry remains weak primarily due to a dominant incumbent ie. Telstra having substantial market power which is directly attributable to its control over critical bottleneck facilities and its vertically integrated organisational structure.

Presently a key government objective is to meet the long term interests of end users by promoting competition in the industry. A key component of promoting competition is to encourage new entrants by providing access to existing bottleneck facilities in order for those new entrants to establish a market presence without having to incur inefficient costs of infrastructure investment. Primus supports the Government's objective to encourage efficient infrastructure investment. However, if competitors are unable to obtain access on reasonable terms and conditions to existing bottle neck facilities which are critical for competitors to be able offer services, those new entrants will be discouraged from investing in new and innovative network infrastructure and facilities.

Access to bottle neck facilities clearly remains a major barrier to establishing sustainable competition in the market.

In nine out of ten access disputes raised with the ACCC Telstra is the access provider. This clearly demonstrates Telstra's control over access to critical network facilities. Until a point is reached when Telstra becomes a significant access seeker, the telecommunications market cannot be considered competitively mature.

Until competitive maturity is achieved telecommunications will remain a market, which exhibits a unique competitive structure and will therefore require industry specific regulation.

Specifically Primus makes the following comments in relation to several views expressed in the Productivity Commission report.

1. The report states that Telstra's share of retail local telephony is likely to be eroded further in the future as a result of increased competition from local call resale and outcomes associated with the declaration of the unconditioned local loop.

   Primus contends that while this undoubtedly is the objective, achieving it in practical terms has proven to be another matter. There have been several disputes lodged with the ACCC by access seekers primarily regarding access prices for LCS.

   It is well understood that customers demand a single bill. This has meant that for carriers to compete effectively they must offer a local call service. This in turn means that carriers are forced to acquire Telstra's local carriage service to resell local calls. Competing carriers have therefore been offering local call services for several years now however the industry is still yet to obtain a regulated wholesale price for that declared service. This has meant that competitors have been at Telstra's mercy and have had no choice but to take the service on Telstra's terms and conditions.

   Similarly there are several access disputes currently with the ACCC about the wholesale price for the unconditional local loop.

   Until these critical wholesale pricing decisions have been settled, Telstra will continue to retain the dominant market share of the local loop and competition in that market will remain weak.

2. Whilst Primus agrees with the Commission that there will be an increased take up of services on competitors' networks in CBD's, this is but a small percentage of the broader telecommunications market. Mature competition will only occur when competitors can effectively break into the broader market, which is dependent upon access to Telstra's bottleneck facilities.

3. The Commission refers to provision of local telephony services on competitors' new cable based and wireless local access networks. These alternative networks and technologies have had minimal impact as a viable alternative to Telstra's local loop network. One only has to look at the relatively poor take up of telephony services on Optus' cable network as an example.

   Deployment of wireless local access networks has been slow and the number of telephony services operating on these networks is small compared to over 95% of the market which still uses Telstra's local access network.

4. Primus accepts the Commission's view that growth in mobile services is becoming a closer substitute for fixed network access services. However, whilst competition in the retail side of mobile services may be well developed, wholesale prices for mobile services remains uncompetitive and the wholesale costs to access seekers to provide such services as fixed to mobile still remain well above actual cost of supply.

Commission's Recommendations

Draft Recommendation 5.1

The Commission recommends that the anti-competitive conduct provisions of Part XIB of the *Trade Practices Act 1974* (TPA) be repealed.

Primus strongly objects to this recommendation.

In making this recommendation the Commission appears to rely heavily on the argument that because Part XIB has not been used extensively, that the provision must therefore be ineffective and/or redundant. Primus contends that part XIB should be retained for the following reasons:

1. The fact that Part XIB has not been used extensively demonstrates that it is acting as an effective deterrent to potential anti-competitive conduct.

2. The telecommunications market continues to exhibit unique characteristics which require specific targeted anti-competitive provisions that would not be provided for in the general anti-competitive provisions under Part IV of the Act.

3. Part IV of the Act is designed to deal with anti-competitive conduct in mature markets and telecommunications is not a mature market.

Primus' view is that the effectiveness of telecommunications regulation to date is not so much to do with the policy itself but rather the implementation of that policy. In line with that view Primus believes that one of the most significant problems to date has been the speed with which anti-competition matters have been dealt with. Whilst Part XIB may not resolve matters as quickly as Primus or the industry may desire, Primus considers that Part IV would be even slower. A good example of this is the Boral decision where a predatory pricing case was brought in 1994. In that case a decision was not reached until 2001, some seven years after it commenced. This period of time would be completely unacceptable in the telecommunications industry where the nature and structure of the market is changing at a rapid rate. One-Tel for example would have come and gone in the time it would have taken to resolve a telecommunications anti-competition matter under Part IV, if the Boral case is any guide.

Indeed there is clear evidence that Part XIB has been effective in those instances where action has been initiated. Primus refers here to the competition notices issued by the ACCC regarding internet peering. This resulted in Telstra changing its behaviour rather than choosing to defend the matter. This demonstrates that Part XIB is more likely to produce faster and more effective outcomes with reduced chance of regulatory error than would the type of process under Part IV of the Act.

It is interesting to note that the draft report identified that all industry participants other than Telstra support the retention of Part XIB. Primus contends that those parties seeking to have Part XIB repealed have not demonstrated that Part IV would produce better outcomes for the industry and end users.

Draft Recommendation 8.1

The Commission recommends that the objects clause in s.152AB(1) of Part XIC of the TPA be broadened from the long-term interests of end-users (LTIE) to the following:

> **The object of this Part is to enhance overall economic efficiency by promoting efficient use of, and investment in, telecommunications services.**

Draft Recommendation 8.2

The Commission recommends that s.152CR of Part XIC and s.3, s. 389, s.384(5) and s. 485(5) of the *Telecommunications Act 1997* be amended so that references to the LTIE test are to the broader objects clause in Part XIC of the TPA.

Primus does not support this recommendation.

Primus does not believe the Productivity Commission has presented compelling evidence to suggest that the LTIE test should be replaced by an "economic efficiency" test.

It appears that the Commission's desire to do so is merely to bring the test into line with the objects of Part IIIA. Primus believes that the risks in changing the current statutory criteria that the ACCC applies in service declarations, access arbitrations and undertakings, far outweigh any supposed benefit that may be achieved by merely aligning the objectives clause with that in Part IIIA.

Whilst in an ideal or mature competitive market a purist economic efficiency test may be sufficient, Primus contends that the unique competitive structure and nature of the telecommunications industry is much better suited to an LTIE test. Whilst an economic efficiency test may produce a theoretically acceptable "economic" outcome, it may do so at the expense of one or the other of the access providers, access seekers or end users. Whereas the LTIE test appropriately ensures that regulatory decisions are taken in the interests of all parties, with the objective of delivering benefits to users of telecommunications services through specifically promoting competition between access providers and access seekers.

Draft Recommendation 8.3

The Commission recommends that for a telecommunications service to be declared it must meet all of the following criteria:

(a) the telecommunications service is of significance to the national economy and

1) for a service used for originating and terminating calls, there are substantial entry barriers to new entrants arising from network effects or large sunk costs; or

2) for a service not used for originating and terminating calls, entry to the market of a second provider of the service would not be economically feasible;

(b) no substitute service is available under reasonable conditions that could be used by an access seeker;

(c) competition in downstream markets is insufficient to prevent the provider of the service from exercising substantial market power;

(d) addressing the denial of access, or the terms and conditions of access, to the service concerned is likely to improve economic efficiency significantly; and

(e) access (or increased access) to the service would not be contrary to the public interest.

Primus strongly questions whether the benefit of aligning the declaration criteria with the criteria in Part IIIA would outweigh the costs of doing so. As Primus has stated elsewhere, whilst aligning telecommunications regulation with the general provisions in the TPA may be theoretically desirable, it should only be done so if the benefits clearly outweigh the potential costs and risk of creating uncertainty and inflexibility.

Telecommunications is a dynamic industry with rapidly changing technologies. To enshrine declaration principles in legislation runs the very real risk of removing the flexibility needed by the regulator to keep up with these changes in technologies and services. Primus can see no need to legislate the criteria when the ACCC has extensive expertise and experience in this area and results to date have proven to be relatively effective.

Primus' considers that service declaration should be based upon a test of the existence of bottleneck facilities and or market power and/or dominance. Primus also considers that the existing undertakings regime is open to regulatory gaming by the incumbent to delay declaration and reap monopoly profits in the meantime (this is discussed further under recommendation 9.10).

Draft Recommendation 8.4

In addition to the existing revocation mechanism under s.152AO, the Commission recommends that Part XIC of the TPA should include an explicit provision for sunsetting declarations, with a reasonable sunset period to be set at the time of declaration.

Draft Recommendation 8.5

The Commission recommends that where a service has expired or is of residual importance, declaration may be revoked by the ACCC without a full public inquiry.

Whilst Primus sees benefit in inserting sunset provisions into declarations it does not support doing so without some degree of public consultation. Primus agrees with the Commission that sunsetting would reflect the fact the underlying motivations for declaration of a particular service may vanish in time with technological change or maturing competition in facilities. However, the assessment of any such technological change or maturity in market competition should be determined in consultation with the industry. For the regulator to make such decisions without necessarily obtaining the benefit of industry input would risk the regulator making ill-informed decisions. Such industry consultation need not be a lengthy or onerous process and could be dealt with expeditiously.

For similar reasons Primus contends that the ACCC should consult industry when it is considering that a declared service has expired or is of residual importance.

Draft Recommendation 9.1

The Commission recommends the retention of provisions for a telecommunications-specific access regime. However, it should be governed by objectives and principles convergent with those of Part IIIA.

Primus agrees with the Commission that provisions for a telecommunications specific access regime should be retained. However, it would seem inconsistent to have a telecommunications specific access regime governed by the general objectives and principals under Part IIIA. The whole purpose for having a specific access regime is to recognise the unique characteristics and requirements associated with access in that market. Therefore, Primus believes that telecommunications specific objectives and principals are required which cannot be met by those in Part IIIA.

This view is supported by the Government's recently proposed legislative amendments to Part XIC. The fact the Government recognises the need for further specific provisions under Part XIC, demonstrates that telecommunications access requirements are complex and need to be carefully tailored in order to meet telecommunications specific objectives.

The current regime is designed to encourage infrastructure investment and clearly contemplates that a precursor to achieving that objective is to provide reasonable access to existing facilities.

Encouraging infrastructure investment whilst at the same time ensuring appropriate conditions exist for new entrants to gain access to existing facilities is a delicate balancing act and a critical one for sustained competition in the industry. This is a unique economic and social policy issue which is evidence of the need for specific regulatory legislation which would not be adequately addressed by the general provisions under Part IIIA.

Draft Recommendation 9.2

The Commission recommends that the ACCC remains the appropriate body to oversee telecommunications-specific competition regulation.

Primus supports this recommendation. Further Primus recommends that the skills and resources of the ACCC's telecommunications division be substantially increased in order for it to be able to deal more expeditiously with the increasing range of complex issues facing it.

In addition Primus believes that the ACCC should be responsible for all industry issues affecting competition and to that extent recommends that the responsibility for numbering and preselection be transferred from the ACA to the ACCC.

Primus believes that in some cases, the ACCC has been reluctant to take on the incumbent carrier for fear of legal challenge. Increasing the ACCC's resources in this area should assist the ACCC in carrying out its functions and powers and not be deterred by the regulatory muscle of the incumbent.

Draft Recommendation 9.3

The Commission recommends the removal of the discretion for Ministerial pricing determinations under Division 6 of Part XIC of the TPA. If this is not accepted, published reasons for any Ministerial pricing decisions should be required.

Primus agrees that should the discretion for Ministerial pricing determinations remain that reasons for any such decision must be published.

Draft Recommendation 9.4

The Commission is inclined to recommend the abolition of the Telecommunications Access Forum, but invites comments on its possible future value.

Primus considers that the Telecommunications Access Forum has been largely ineffective. Two of the main reasons for this are conflicting interests of members and the overwhelming influence of Telstra which has the capability to "out resource" other members. The TAF's role in recommending services for declaration is arguably redundant.

Draft Recommendation 9.5

The Commission recommends that s. 152CPA(3) of Part XIC of the TPA – which does not permit the ACCC to make an interim determination if an access seeker objects to it – be repealed.

Primus has no objection to this recommendation. Primus understands that this will be incorporated in the Government's recent proposed legislative amendments.

Draft Recommendation 9.6

The Commission recommends that s. 152CN(1) of Part XIC of the TPA be modified to allow notifications by an access provider or seeker to be withdrawn only with the joint consent of the access provider and seeker.

Primus strongly supports this recommendation. Primus understands that this will be incorporated in the Government's recent proposed legislative amendment package.

Primus' only concern is that the recommendation as drafted could provide a party the ability to lock another party into arbitration. However Primus understands that under the proposed legislative amendments being put forward by Government that the ACCC would have a discretion to impose such a decision and therefore this risk of regulatory gaming should not arise.

Draft Recommendation 9.7

The Commission recommends that there should be the capacity for a group of access seekers to lodge a joint notification of dispute and proceed to class arbitration rather than a series of bilateral negotiations.

Primus fully supports this recommendation.

Primus understands that the recent proposed legislative amendment package addresses this to a limited extent, but does not go so far as to propose that access seekers be allowed to lodge joint notifications. If the ACCC is to be given discretion to join arbitrations, Primus believes it should do so only on the condition that it considers that it would result in the promotion of the object of Part XIC or in the common disputes being resolved in a more timely or efficient manner. This would ensure such an action has regard to the long term interests of end users.

Draft Recommendation 9.8

The Commission recommends that the ACCC should exercise its discretion in allowing the arbitrator to use and disseminate to contesting parties in an arbitration relevant material submitted in other telecommunications access arbitrations:

- **subject to the requirement that it have regard to the material's potential commercial sensitivity**

Primus fully supports this recommendation.

Primus understands that this will be incorporated in the recent proposed legislative amendment package. Primus recommends that the ACCC should only exercise this discretion if it considers that it would result in the promotion of the object of Part XIC or in the common disputes being resolved in a more timely or efficient manner. This would ensure such an action has regard to the long term interests of end users.

Draft Recommendation 9.9

The Commission recommends that merit appeals not be extended to declarations or interim determinations, with the exception of the case where the ACCC rejects a declaration and a party wishes to contest that rejection.

Primus supports the recommendation.

Draft Recommendation 9.10

The Commission recommends that:

- **the ACCC produce a published method for calculating any backpayment under s. 152DNA of Part XIC of the TPA, which should include the provision for payment of interest and indicate how the appropriate time period for backpayment should be gauged; and**

- **s. 152DNA specify that an access price consistent with the published method should be backdated and that obligations to pay backpayments should not discriminate between access seekers and providers.**

Primus believes that there should be provision to enable backdating to be effective from the time the access seeker acquires the service or at minimum the date at which access negotiations commenced.

Until a party files a notice of an access dispute with the Commission, the price it pays for the relevant service is effectively unregulated and therefore the access provider can engage in monopolistic pricing of that service.

In Primus' experience that has tended to encourage access providers to file access undertakings with the Commission which are unreasonable (within the meaning of s. 152AH of the TPA) and to delay negotiations with access seekers and therefore the filing of a dispute notice by the access seeker. This outcome is contrary to the purpose and objects of Part XIC and has, in Primus' experience resulted in inefficient access prices, less competition in relevant markets and higher retail prices.

This has, in Primus' view, been one of the most significant failings of the Part XIC access regime and has enabled access providers to reap arbitrage profits for the period between the commencement of negotiations for access prices between the parties and the filing of a notice of access dispute by the access seeker.

Accordingly backdating should take effect from the date of supply or when negotiations commenced.

Draft Recommendation 10.1

The Commission recommends that the following principles be legislated for telecommunications. Access prices should:

- **generate revenue across a facility's regulated services as a whole that is at least sufficient to meet the efficient long-run costs of providing access to these services, including a return on investment commensurate with the risks involved;**
- **not be so far above costs as to detract significantly from efficient use of services and investment in related markets;**
- **encourage multi-part tariffs and allow price discrimination when it aids efficiency; and**
- **not allow a vertically integrated access provider to set terms and conditions that discriminate in favour of its downstream operations, unless the cost of providing access to other operators is higher.**

Primus does not support this recommendation. Whilst these may form a set of theoretical pricing principles at a generic level, they may restrict the ACCC's flexibility to develop pricing principles to suit the dynamic nature of telecommunications.

Whilst Primus does not support legislating pricing principles it does support the requirement that the ACCC determine and publish pricing principles for application in access disputes. To that extent Primus supports the Government's proposed legislative amendment to s. 152AQA as part of its proposed legislative amendments.

Further to that it must be a requirement that the ACCC, in determining pricing principles, consult with industry before doing so.

Draft Recommendation 10.2

The Commission recommends that the retail price controls that lead to the access deficit be removed.

Without prejudice to Primus' position as to whether or not an access deficit in fact exists, Primus supports the recommendation.

Draft Recommendation 10.3

The Commission recommends that there be public disclosure by the ACCC of the costing methodologies on which arbitrations are based and the justification for the approach adopted. This need not include publication of the prices associated with particular arbitrations or of particular commercial-in-confidence cost parameters.

Primus supports the recommendation.

Primus understands that this will be incorporated in the Government's proposed set of legislative amendments.

Draft Recommendation 11.1

The Commission recommends that the legislative requirement for Industry Development Plans should be repealed. Existing plans should also cease.

Primus supports this recommendation.

Primus expends significant resource on development of its IDP and believes that there is no perceived benefit arising from the IDP in relation to costs incurred.

Draft Recommendation 11.2

The Commission recommends that the facilities access regimes under Parts 3 and 5 of Schedule 1 of the *Telecommunications Act 1997* should be consolidated into Part XIC of the TPA.

Primus does not object to this recommendation.

Draft Recommendation 11.3

The Commission recommends that the procedures and obligations under the mandatory network information requirement should be aligned, regardless of the type of information being requested.

Primus fully supports the legislative requirement mandating sharing of network information. Primus would be severely restricted if Telstra in particular was able to withhold vital network information.

Primus does not oppose the recommendation.

Draft Recommendation 11.4

The Commission recommends that the mandatory network information provisions under Part 4 become a standard under Division 5 of Part 21 of the *Telecommunications Act 1997*.

Primus supports the recommendation.

Draft Recommendation 17.1

The Commission recommends that power to determine the aggregate universal service levy lie with the ACA, rather than the Minister, with provision made for full merit review of determinations by the Australian Competition Tribunal.

Primus does not support this recommendation.

The recommendation as drafted would risk increasing delays particularly if it is made subject to merit review.

Other Issues

Structural Separation of Telstra

Whilst Primus recognises that the issue of structural separation of Telstra was not included in the terms of reference for the Productivity Commission's review, Primus believes that this is a matter which requires further consideration.

Primus believes that one area which continues to frustrate Telstra's rivals is the ability of Telstra to fail or refuse to offer reasonable wholesale prices for "monopoly" or bottleneck services which are not declared and therefore not subject to regulatory intervention.

Primus considers that Telstra continues to gain a significant unfair competitive advantage through its ability to supply "monopoly" services to itself on terms that discriminate against its rivals.

That is, Telstra is able to gain an unfair advantage in the supply of downstream competitive services by obtaining upstream "monopoly" services from its own organisation on preferential terms.

Telstra is able to do so primarily because of its vertically integrated organisational structure and the absence of any adequate regulatory controls in that area.

At a minimum Telstra should be made to supply "monopoly" services to itself on the same terms and conditions as it supplies them to others. Primus is not confident that accounting separation arrangements are effective in achieving this outcome and that government needs to reconsider the need for either greater transparency and enforcement of Telstra's internal transfer pricing arrangements or move to structural separation of Telstra's wholesale and retail business operations.

Primus recommends that a separate public inquiry be held into this issue.
